IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1987

No. 87-1020

PAUL S. DAVIS,

Appellant,

v

STATE OF MICHIGAN,
DEPARTMENT OF TREASURY,

Appellee.

ON APPEAL FROM THE
SUPREME COURT OF THE STATE OF MICHIGAN

MOTION TO DISMISS OR AFFIRM

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QUESTION PRESENTED

MAY THE STATE OF MICHIGAN EXEMPT RETIREMENT BENEFITS FROM STATE INCOME TAX WHICH IT OR ITS POLITICAL SUBDIVISIONS PAY TO THEIR RETIREES, WHILE STILL IMPOSING THE INCOME TAX ON ALL OTHER RETIREMENT BENEFITS IN EXCESS OF $7,500?

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Pursuant to United States Supreme Court Rule 16, Appellee moves that Appellant's appeal from the Opinion of the Michigan Court of Appeals (JS A1-A6)[1] and from an

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[1] Unless otherwise indicated, numbers in paranthesis preceded by "JS" will refer to pages of Appellant's Jurisdictional Statement.

Order of the Michigan Supreme Court denying leave to appeal, entered September 28, 1987 (JS A9), be dismissed on the following grounds:

1. That the appeal does not present a substantial federal question; and

2. That the Opinion of the Michigan Court of Appeals is conclusive.

In the alternative, Appellees move that the opinion be affirmed on the grounds that it is manifest that the question on which the decision of this cause depends is so insubstantial as to need no further argument.

STATEMENT OF THE CASE

The sole issue presented by this case is succinctly stated in the Opinion of the

Michigan Court of Appeals. Therein the Court states that:

> "The issue on appeal is whether the Michigan Department of Treasury has the authority to impose an income tax on plaintiff's federal retirement benefits. Under the Michigan Income Tax Act, MCL 206.1 *et seq*; MSA 7.557(101) *et seq*, plaintiff was permitted to deduct from his taxable Michigan income no more than $7,500 of the amount he received in federal retirement benefits. MCL 206.30; MSA 7.557(130). By comparison, the same statutory provision permits state retirees receiving benefits from a public retirement system of the state or its political subdivisions to deduct retirement benefits in full. It is this differing tax treatment of retirement benefits which forms the basis of plaintiff's refund claims." (JS A2).

Stated alternatively, this appeal draws into question the authority of the Michigan legislature to separate into different classifications, for Michigan income tax purposes, those retirees

receiving benefits from the public retirement system of the State of Michigan or its political subdivision from all other retirees.

Appellant requested from Appellee a refund of Michigan income tax paid by him. His request was based upon his contention that federal retirement benefits were not subject to Michigan income tax. Appellant's refund request was denied and he subsequently filed suit in the Michigan Court of Claims asserting that the Michigan income tax was discriminatory as to source, and therefore unlawful under federal law. The Michigan Court of Claims ruled in favor of Appellee, holding that the imposition of the Michigan income tax upon retirement benefits received by federal retirees, while exempting

retirement benefits from public retirement systems of the state or its political subdivision, did not violate 4 U.S.C. 111 (JS A10-A13).

On appeal, the Michigan Court of Appeals upheld the trial court's judgment that Appellant, as a former federal employee, was not within the definition of employee as that term is used in 4 U.S.C. 111, and therefore, not entitled to the protection afforded by that statute. (JS A4). The Court also ruled that Appellant's contention that "...the imposition of a Michigan income tax on his federal retirement benefits is unlawful because it discriminates by source and burdens federal goverment activities..." was untenable. (JS A6).

The Appellant sought leave to appeal in the Michigan Supreme Court which denied Appellant's application. (JS A9). It is from this decision that Paul S. Davis appeals to this Court.

ARGUMENT

THE MICHIGAN INCOME TAX ACT, IN AFFORDING DIFFERING TREATMENT TO RETIREMENT AND PENSION BENEFITS RECEIVED BY STATE RETIREES AND RETIREES OF ITS POLITICAL SUBDIVISIONS IS A VALID EXERCISE OF THE STATE POWER TO CLASSIFY FOR TAX PURPOSES AND BEARS A RATIONAL RELATIONSHIP TO A LEGITIMATE STATE END.

The Michigan Income Tax Act addresses the treatment of retirement and pension benefits at § 30(1)(h), MCL 206.30(1)(h); MSA 7.557(130) and provides as follows:

(1) "Taxable income" in the case of a person other than a corporation, an estate, or a trust means adjusted gross income as defined in the internal revenue code subject to the following adjustments:

* * *

(h) Deduct to the extent included in adjusted gross income:

(i) Retirement or pension benefits received from a public retirement system of or created by an act of this state or a political subdivision of this state.

(ii) Any retirement or pension benefits received from a public

retirement system of or created by another state or any of its political subdivisions if the income tax laws of the other state permit a similar deduction or exemption or a reciprocal deduction or exemption of a retirement or pension benefit received from a public retirement system of or created by this state or any of the political subdivisions of this state.

(iii) Retirement or pension benefits from any other retirement or pension system as follows:

(A) For a single return, the sum of not more than $7,500.00.

(B) For a joint return, the sum of not more than $10,000.00.

For the years in question, the Appellant was permitted, under the Act, to deduct $7,500.00 of the amount received in Federal Civil Service retirement benefits. Mr. Davis claims that the entire amount of his retirement benefits should be exempt from state taxation.

The Appellant first argues that 4 U.S.C. 111 *supra*, applies. This section provides as follows:

> The United States consents to the taxation of pay or compensation for personal service as an *officer* or *employee* of the United States a territory or possession or political subdivision thereof, the government of the District of Columbia, or an agency or instrumentality of one or more of the foregoing, by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation. (Emphasis added).

For Federal Civil Service purposes, an *officer* is defined at 5 U.S.C. 2104 as follows:

> (a) For the purpose of this title, "officer," except as otherwise provided by this section or when specifically modified, means a justice or judge of the United States and an indivi-dual who is -- (1) required by law to be appointed in the civil service by one of the following acting in an official capacity -- (A) the President;
>
> (B) a court of the United States;
>
> (C) the head of an Executive agency; or
>
> (D) The Secretary of a military department;

> (2) engaged in the performance of a Federal Function under authority of law or an Executive act; and
>
> (3) subject to the supervision of an authority named by paragraph (1) of this section or the Judicial Conference of the United States, while engaged in the performance of the duties of his office.

Furthermore, for Federal Civil Service purposes, an *employee* is defined at 5 U.S.C. 2105 as follows:

> (a) For the purpose of this title, "employee," except as otherwise provided by this section or when specifically modified, means an officer and an individual who is -- (1) appointed in the civil service by one of the following acting in an official capacity-- (A) the President;
>
> (B) a Member or Members of Congress or the Congress;
>
> (C) a member of a uniformed service;
>
> (D) an individual who is an employee under this section;
>
> (E) the head of a Government controlled corporation; or

(F) the adjutant general designated by the Secretary concerned under section 709(c) of title 32;

(2) engaged in the performance of Federal function under authority of law or an Executive act; and

(3) subject to the supervision of an individual named by paragraph (1) of this subsection while engaged in the performance of the duties of his position.

Neither the Appellant nor the retirement benefits he receives because of his prior status as a federal employee comes within the term of 4 U.S.C. 111, *supra*. To avail himself of this statutory provision, Mr. Davis must be either an officer or employee of the United States. He is neither. Mr. Davis admits that he retired from United States government service but has never contended that he is presently an employee or officer of the United States government.

In *Lancellotti v Office of Personnel Management*, 704 F2d 91 (CA 3, 1983), the Circuit Court of Appeals concluded that a retired federal civil service employee was not an employee within the definition of employee for civil service purposes.

The definition of employee for Michigan income tax purposes is defined in Michigan Administrative Code 1979, R 206.2. Essentially, the rule provides that a relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the service, not only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished. In other words, an employee is subject to the will and

control of the employer, not only as to what shall be done, but also as to how it shall be done. In addition, the employer possesses the right to discharge the employee.

This Court dealt with the definition of employee and the status of retired workers in *Allied Chemical and Alkali Workers of America v Pittsburgh Plate Glass Co*, 404 US 157; 92 S Ct 383; 30 L Ed 2d 341 (1971). In this case this Court defined employees as persons who worked for wages or salaries under direct supervision. The Court concluded that the ordinary meaning of employee does not include retired workers since retired employees have ceased to work for another.

Since the Appellant does not fit within the definition of either employer or

officer, as those terms are commonly used in applicable statutes and court decisions, the provisions of 4 U.S.C. 111, *supra*, simply do not apply.

The Michigan Court of Appeals agreed with this premise, holding that Appellant, under the Civil Service Retirement Act, was an annuitant, and defined as a *former* employee, 5 U.S.C. 8331(9). As such, Appellant as

> ... an annuitant is not considered an employee at the time he receives his annuity payments. Additionally, Plaintiff has failed to show any express legislative intent or case authority to give a broad construction to the term employee as contained in 4 U.S.C. 111 to encompass retired employees. Indeed, we believe that had Congress so intended it would have clearly so provided. (JS A6).

The Appellant also argues that the United States Supreme Court decision in

Memphis Bank and Trust Co v Garner, 459 US 392; 103 S Ct 692; 74 L Ed 2d 562 (1983), prohibits the State from taxing his retirement benefits. In *Memphis Bank and Trust Co, supra*, this Court determined that a Tennessee statute imposing a tax on the net earnings of banks doing business in the State of Tennessee which included interest received on obligations of the United States and its instrumentalities and of other states, but not interest earned on obligations of Tennessee and its political subdivisions, violated 31 U.S.C. 742 the predecessor of 31 U.S.C. 3124, *supra*. The Court found that the tax act, by favoring securities issued by Tennessee and its political subdivisions over federal obligations by including in the tax base income from federal obligations while excluding income

from otherwise comparable state and local obligations, improperly discriminated against the federal government and those with whom the federal government dealt.

The Appellant, to come within the confines of the decision reached in *Memphis Bank and Trust, supra*, must show that retirement benefits received under the United States' Government Civil Service Retirement Act are obligations of the United States government. 31 U.S.C. 3124, *supra*, provides in pertinent part as follows:

> (a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except-- (1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation; and

(2) an estate or inheritance tax.

Clearly, the purpose of former section 742, now section 3124, was to prevent state taxation which diminished in the slightest degree the market value or investment attractiveness of obligations issued by the United States in its effort to secure necessary credit. See *Smith v Davis*, 323 US 111; 55 S Ct 157; 80 L Ed 107 (1944) and *American Bank & Trust Co v Dallas County*, 463 US 855; 103 S Ct 3369; 77 L Ed 2d 102 (1983). Congress intended such obligations to include bonds, treasury notes and other like obligations since these are the traditional instruments used by the federal government to secure credit. No case law exists interpreting this section or its predecessor to indicate there was any

intent by Congress to include, within the definition of obligations, benefits received under the Civil Service Retirement Act.

Appellant misconstrues the character of the case when he argues that the tax treatment afforded state retirees receiving retirement benefits from a public retirement system of the state or its political subdivision is discriminatory as compared to the tax treatment afforded all other retirees. This is not a discrimination case. It is a classification case.

There are a host of cases decided by this Court which uphold reasonable classifications for tax purposes. Among such cases are *Bell's Gap R Co v*

Pennsylvania, 134 US 232, 237; 10 S Ct 533; 33 L Ed 892, 895 (1899); *Magoun v Illinois Trust & Sav Bank*, 170 US 283, 293; 18 S Ct 594; 42 L Ed 1037 (1897); *Southwestern Oil Co v Texas*, 217 US 114, 121; 30 S Ct 496; 54 L Ed 688, 692 (1909); *Brown-Forman Co v Kentucky*, 217 US 563, 573; 30 S Ct 57; 54 L Ed 883 (1909); *Heisler v Thomas Colliery Co*, 260 US 245, 255; 43 S Ct 83; 67 L Ed 237, 241 (1922); *Oliver Iron Mining Co v Lord*, 262 US 172, 179; 43 S Ct 526; 67 L Ed 929, 936 (1922); *Stebbins v Riley*, 268 US 137, 142; 45 S Ct 424; 69 L Ed 884 (1924); *Ohio Oil Co v Conway*, 281 US 146, 159; 50 S Ct 310; 74 L Ed 775, 781 (1929); *State Tax Comrs v Jackson*, 283 US 527, 537; 51 S Ct 540; 75 L Ed 1248 (1930); *Allied Stores v Bowers*, 358 US 522; 79 S Ct 437; 3 L Ed 2d 480 (1959).

The Michigan Court of Appeals clearly recognized that this case involved classification for tax purposes when it applied an equal protection analysis, and correctly held that "...a statute will be upheld against an equal protection attack if the distinctions bear a rational relationship to a legitimate state end...." (JS A6-7).

In the instant case, two separate classes of retirees have been afforded different taxing treatment. The first class (and the much smaller of the two) includes those that receive retirement benefits from a public retirement system of the State of Michigan or its political subdivisions. The second class consists of all other retirees, which include Appellant.

The burden of showing that the classification lacks justification and that there is no conceivable basis which might support the classfication is upon Appellant. *Lehnhausen v Lake Shore Auto Parts Co*, 410 US 356; 93 S Ct 1001; 35 L Ed 2d 351 (1973).

As indicated by the Michigan Court of Appeals:

> Under the Michigan income tax system, a class distinction is made between state retirees and all other retirees, including federal retirees. In our opinion, the attracting and retaining of qualified employees is a legitimate state objective which is rationally achieved by a retirement plan offering economic inducements. One such inducement to state employees is tax exempt status for their retirement benefits. The State of Michigan, as an employer, owes a special responsibility to its employees, which it does not owe to federal employees. The full tax exemption permitted by the MITA is simply intended to recognize that income tax exemption is an integral part of the retirement benefits conferred upon state employees." (JS A7).

Appellant has failed to show that there is no reasonable basis for the statutory classification.

The jurisdictional statement does not present any substantial federal question. It is so wanting in substance in view of previous decisions of this Court sanctioning reasonable classifications for tax purposes as to warrant no further argument.

RELIEF

WHEREFORE, Appellees respectfully submit that the question upon which this cause depends is so insubstantial as not to need further argument, and Appellees respectfully move this Court to dismiss this appeal, or, in the alternative, to affirm the order entered in this cause by

the Supreme Court of the State of Michigan.

Respectfully submitted,

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